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HOW FARES THE AFGHAN PRIVATE SECTOR?

Trying to run a business in a "stagnant" economy

AFGHANISTAN ANALYSTS NETWORK

Afghanistan Analysts Network

Economy, Development, Environment

September 2024

Everyone agrees that the private sector will be crucial to getting any real growth back into the Afghan economy. The World Bank has said that long-term growth is "contingent upon a significant shift … to a more resilient, private sector-led economy." Earlier in the year, however, it described the Afghan economy as "persistently stagnant," with real growth in GDP flatlining. Officials responded by pointing to positive indicators, such as the Emirate's record in attracting investment and increasing exports, as well as other dynamics the Bank is worried about, such as the strong currency and deflation. Given that the private sector is where hope lies, Kate Clark and the AAN team wanted to find out what running a business in today's Afghanistan is like. They heard from a range of businessmen and women about the problems they face and what would help their enterprises. The aim was to set their day-to-day experiences as the context for scrutinising the World Bank's analysis and the Emirate's more positive take on the current state of the Afghan economy.

The Islamic Emirate has reverted to using the Afghan calendar, which begins on the spring equinox, for its financial year. The World Bank has also largely adopted this. To avoid confusion, this paper uses both, for example, 1403/2024 would cover 21 March 2024 to 20 March 2025.

For ease of comparison, an exchange rate of 85 afghanis to the dollar is used throughout this paper.

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INTRODUCTION

"Despite sanctions and pressures," acting Deputy Minister for the Economy Ali Latif Nazari said of the Emirate's first year in power, it had managed to "prevent economic collapse," while in the second year, it had concentrated on boosting the economy, using growth and expansion to "improve the people's livelihoods."[1] The World Bank's first assessment of the economy following the takeover, 'Afghanistan Development Update: Adjusting to the New Realities', published in October 2022,[2] was relatively optimistic given the scale of the crash in 2021. It said the economy was "plateauing around a low-level equilibrium" and predicted it would be "moving to a low-growth path (2.0 to 2.4 per cent) for the next two years," although, given population increases, there would be no per capita growth. Far gloomier was its most recent Development Update (published twice a year), which came out in April 2024 (Afghanistan Development Update, Navigating Challenges: Confronting Economic Recession and Deflation) and described economic activity as "stagnant" with a downturn "characterized by poverty, food insecurity, high unemployment, and underemployment." It predicted that, throughout 2023-25, the economy would remain "persistently stagnant," with real gross domestic product (GDP) growth flatlining, "leaving economic activity by 2025 at par with 2022 levels as per capita income shrinks due to population growth."

Islamic Emirate spokesman Zabiullah Mujahid responded by saying the Afghan economy had faced stagnation in the past, but since the country had become secure and regained its sovereignty in August 2021, the economy had been growing. The future, he insisted, was bright (quoted by state broadcaster, Radio Television Afghanistan (RTA), here). Other IEA officials also rejected some of the Bank's figures and forecasting, as seen below.

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[1] Nazari was speaking at the accountability session of the Ministry of Economy in the summer of 2023. For a fascinating look at the accountability sessions, where 42 ministries and agencies spoke about their achievements during the previous year to a gathered press corps, see Martine van Bijlert's report for AAN, 'How The Emirate Wants to be Perceived: A closer look at the Accountability Programme', 9 July 2024.

[2] On its website, the World Bank calls the development updates, "comprehensive report[s] of the state of the Afghan economy," which cover "recent economic developments and the medium-term outlook."

This report is an attempt to assess the Afghan economy and prospects for private-sector growth as the IEA passes the end of its third year in power. However, its starting point is not the Bank’s analysis, nor the Emirate’s more positive take, but the experiences of businessmen and women in the all-important private sector. For Afghanistan’s economy to grow over the long term, the World Bank has said there must be “a significant shift from the previous 15 years of reliance on international aid and consumption-driven growth to a more resilient, private-sector led economy that capitalizes on the nation’s inherent strengths.” ‘Enabling the Private Sector’ was also one of two topics chosen for discussion between the IEA and special envoys at the Doha III conference held on 30 June and 1 July (the other was counter-narcotics). The meetings were held behind closed doors and there has been little reporting on their substance. However, IEA spokesman and head of the delegation, Zabihullah Mujahid, said their messages had “reached all participating” countries at the meeting, and that “[m]ost countries expressed their willingness to cooperate in these areas.” What, though, are the problems facing Afghanistan’s private sector?

We spoke to nine business owners – seven men and two women, all with employees and all but one with a business predating the fall of the Republic. They included a trader in onions and potatoes, a manufacturer of pressure cookers and a herbalist. Three interviewees said their businesses were flourishing, one after a significant decline because of Covid-19, followed by the change of government and economic collapse. Other businesspeople spoke of plummeting sales and having to lay employees off or dip into savings to retain staff when profits could not cover wages. They described problems ranging from shrinking consumer demand to delays and bureaucracy at customs, high taxes, cheap imports, lack of capital and a patchy electricity supply.

The first section of this report looks at these day-to-day problems in turn after a little context about the private sector under the Republic and since the Taleban takeover. The businesspeople’s accounts are followed by a closer look at the main takeaways of the World Bank’s most recent Afghanistan Development Update, published in April 2024, and the Emirate’s response to it, before taking a closer look at some of the knottier problems highlighted by the Bank. The paper ends by looking at what those businesspeople, the Bank and the Islamic Emirate say would help the Afghan private sector, as well as the wider economy, to flourish.

Why focus on the private sector?

Afghanistan’s private sector has, like the rest of the economy, been forced to adjust to very different circumstances since August 2021. During the Islamic Republic, the amount of foreign money pouring into Afghanistan was of a magnitude unparalleled globally. It included civilian aid and military support and, dwarfing both of those, the money spent by the foreign armies in Afghanistan on logistics, transport, rent and local salaries. The result was an extreme form of what political economists call a ‘rentier state’, when a country gets an overwhelming amount of outside, unearned income, or ‘rent’ – so-called because, like a landlord’s rent, the money comes without the need to work or take risks. In a rentier state, the government can rely on that unearned foreign income and has little or no need to tax its citizens. The consequences of this are many and largely negative. For Afghanistan, as the author explored in a 2020 report, they included inhibiting democracy and accountability, promoting patron-client politics, inequality and corruption, the greater say by foreigners over government policy than Afghan citizens, and weakening domestic production.[3]

The vast amounts of foreign money flowing into the economy meant that Afghanistan’s private sector under the Republic was a ‘rentier private sector’, able to make profits without needing to mobilise productive resources.[4] Indeed, the most important ‘resource’ to possess during those years were contracts with either the foreign military, the government or parliament. Profits were eye-wateringly large for those able to get foreign or government contracts, and businesses flourished whose entire *raison d’être* was to serve the international aid and military economy. Beyond that, the foreign money sloshing around the economy created artificial demand. It drove up wages, the cost of property – to buy or rent – and

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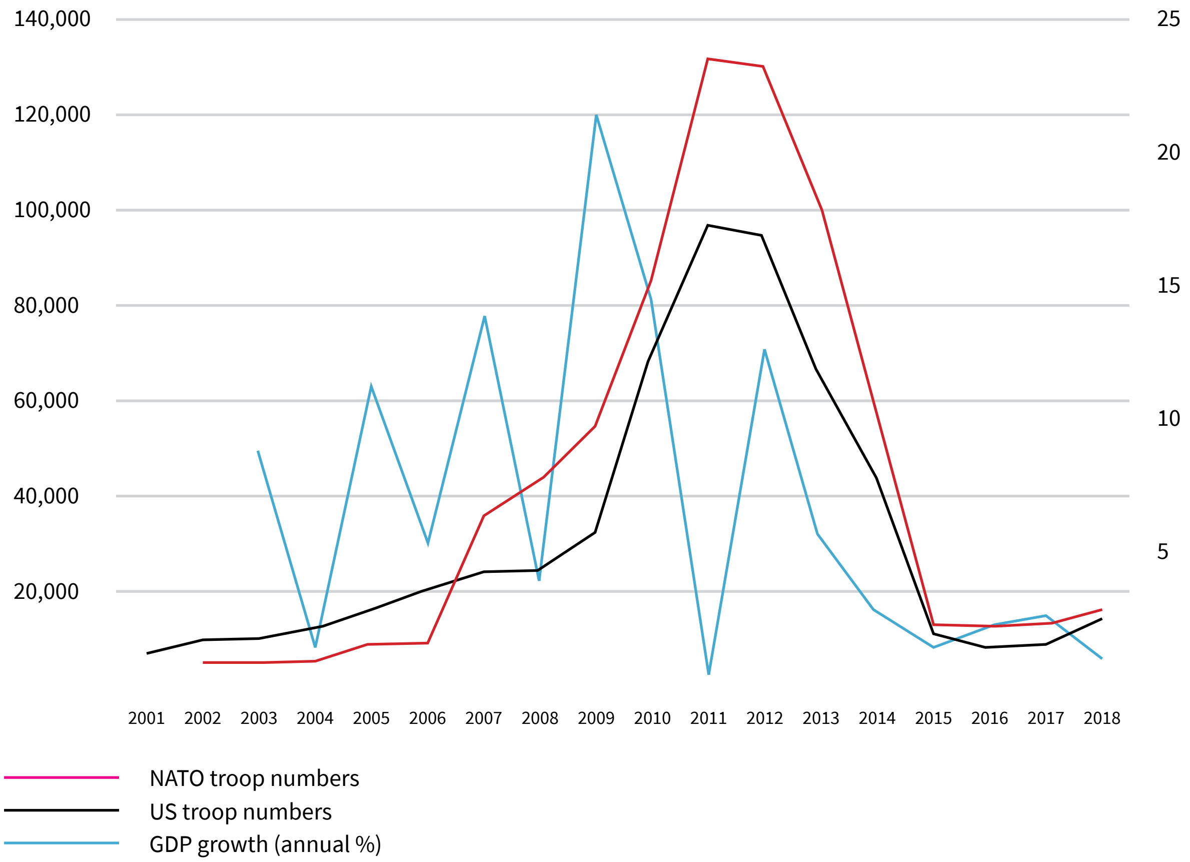
[3] For more on this, see AAN’s 2020 report, ‘The Cost of Support to Afghanistan: Considering inequality, poverty and lack of democracy through the ‘rentier state’ lens’, which looked at how the magnitude of unearned income flowing into Afghanistan distorted both the state/citizen relationship and the economy.

[4] As well as having a ‘rentier private sector’, Afghanistan also had a ‘rentier insurgency’ in those years. The Taleban funded their fight by taxing farmers, businesspeople, NGOs and traders living in areas under their control or influence and demanding protection money from others, for example, truckers delivering supplies to the foreign armies’ bases. Meanwhile, public services continued to be funded by taxpayers, either foreign or Afghans living in Republic-held areas. For more on this see, ‘The Cost of Support’, cited in footnote 4, and also two AAN research projects from 2018-21, collected together in the dossier, ‘Dossier XXIX: Living with the Taleban’ that looked at service delivery in insurgent-affected areas, and local citizen/Taleban interactions, including taxation.

the value of the afghani, all of which made exports more expensive and sucked in imports. Construction and the service sector boomed while domestic production withered. A functioning domestic economy was of little political importance because the government had little need for tax. That shifted a little under the two Ashraf Ghani presidencies, as foreign rent diminished, especially with the end of the NATO-led, UN-mandated International Security Assistance Force (ISAF) mission in 2014 and the reduction in the number of foreign troops and their associated spending in Afghanistan.

Figure 1: The deployment of international forces and economic growth in Afghanistan



Source: ‘[The Cost of Support to Afghanistan](#)’, Afghanistan Analysts Network Special Report, May 2020.

Much of what was touted as economic growth during the Republic fell away as that income dropped. Notably, poverty levels rose with the end of the ISAF mission in 2014, as can be seen in Figure 1, which given the difficulty in determining how much armies spend in Afghanistan and how much aid of all types is given, uses the number of international forces deployed as a proxy for rent coming into the country. The mirroring of economic growth with deployment is evident. The major anomaly is 2011 when, despite high numbers of foreign troops, drought severely affected agricultural production; agriculture is a major and volatile component of Afghanistan's GDP.

Poverty levels rose even more sharply after August 2021, when the sudden cessation of the rent caused immediate and catastrophic damage to the economy. In the last years of the Republic, civilian aid and military support had amounted to the equivalent of 43 per cent of Afghanistan's GDP and funded 75 per cent of government expenditure. After the takeover, Afghanistan's real GDP, said the World Bank, contracted by 26 per cent.[5]

In August 2021, consumer demand melted away overnight, and many businesses folded, downsized or were mothballed.[6] People lost their jobs and poverty deepened. The bleakness of the economic crisis was made worse by it coming on top of two years of drought and months of intense fighting, when civilian casualties had soared, crops could not be watered or harvested, and trade was hampered. A month after the fall of Kabul, the World Food Programme assessed that only one in twenty Afghan households had enough to eat. Poverty levels have fallen back, but remain high: according to the World Bank, in October-December 2021, 70 per

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[5] The World Bank report speaks about the contraction of the economy over the "last two years," ie March 2022 to March 2024, the first two full Afghan fiscal years since the re-establishment of the Islamic Emirate.

[6] The World Bank has reported on businesses contracting and folding since the takeover. In its latest Afghanistan Private Sector Rapid Survey (Round 1 was conducted in October-November 2021, Round 2 in May-June 2022 and Round 3 in March 2023), it said:

More surveyed firms reported being in operation in Round 3 than in Round 2, albeit at less than full capacity. In the context of a slight improvement in household welfare amid persistently low demand, businesses continue to adjust to socioeconomic realities in the country. The results of the Round 3 survey show that 57 percent of interviewed firms were fully open and operational, compared to only 28 percent in Round 2…. These figures suggest a slight uptick in economic activity. However, over one-third of respondents indicated that their firm was operating below capacity and another 10 percent said they had closed down, highlighting the difficulties the economy is facing. Data from Round 3 suggests a convergence among different-sized firms in adjusting to shocks, as operating status was broadly similar across small, medium, and large businesses. The improvement in operating status is confirmed when looking specifically at panel firms, of which the share in operation rose from 23 percent in May-June 2022 (Round 2) to 59 percent in March 2023 (Round 3).

The Bank added that there may be a 'survivor's bias' to these results, in that companies would more likely respond if they were still in business.

Round 3 of the survey of 422 firms was conducted in March 2023, but only published in February 2024. "Although some time has elapsed since the data collection for the Round 3 survey," it said, "the data remain relevant in light of the persistence of key business constraints in the context of a 'new normal' for Afghanistan's private sector."

cent of households were unable to meet basic needs (33 per cent only had enough income for food and 36 per cent not enough even for that).[7] By April-June 2023, that proportion of the population had fallen to 63 per cent, with those unable to afford food having risen slightly, to 37 per cent.

This is the context in which the seven businessmen and two businesswomen described how their enterprises were faring. Notably, there is a ‘survivors’ bias’ in the selection of interviewees, as all but one of the businesses predate the fall of the Republic. They are among those who have kept their businesses afloat. The accounts of their day-to-day struggles to stay in business and prosper are telling.

WHAT BUSINESSPEOPLE SAY ABOUT THE ECONOMY

Our nine interviewees, based respectively in Nangrahar, Mazar-e Sharif, Paktia, Bamyan, Kandahar and Kabul, comprised: the owner of a factory that processes pulses; an importer of crockery and glassware for domestic retail, a trader in potatoes and onions; the deputy manager of a factory making pressure cookers; a children’s clothes manufacturer; the owner of a rug-making factory; the owner of an embroidery business; and a herbalist. We also conducted a number of less in-depth interviews in Kandahar.

Three of our nine interviewees said their businesses were doing well. The deputy manager of the factory that sells pressure cookers domestically and for export said output had increased and they had taken on staff in recent years, growing the workforce from 200 to 700 direct and indirect employees. The embroidery business owner selling goods in Afghanistan and abroad was also positive about her business: she now has two to three thousand women in several provinces working directly or indirectly for her company. The owner of the factory processing pulses, herbs and spices, who mainly buys raw pulses domestically and sells them on to traders in his home province and beyond, said his business had been hit hard by the Covid-19 pandemic and collapse of the previous government and resulting economic crisis: “But,” he said, “last year was better than the previous years, and this year our business is again flourishing.”

[7] Figures from the World Bank ‘Afghanistan Welfare Monitoring Survey, Round 3’, published in October 2023.

Every interviewee, however, spoke about the difficulties of operating a business in the current environment. Most have had to downsize. The children’s clothes manufacturer said that five years ago, he had begun with eight workers, expanded to 50 and then, since the change of government, downsized to 20; they include tailors (three of them women), designers and support staff. Even so, the increase in taxes and rent, the lack of a reliable electricity supply and reduced demand all mean that “expenses are high and income is low.” He felt he was forced to run just to stand still “because sales currently only cover the expenses of the workshop and employees’ salaries, tax and the municipality’s *safiat* tax.”[8]

> *The only reason I downsized was because there were no sales. When there are no sales, production stops accordingly. And I could not pay the salaries of all these employees from my own pocket. I kept the employees for some time and tried hard to maybe improve the situation, but the economic situation of the market was deteriorating day by day and I had to let them go.*

The importer and seller of crockery and glassware said his business is now 70 per cent smaller than before the IEA re-took power. He has stopped selling his wares in the provinces and downsized from five to three employees in his shops, and from five to one in the main office. The herbalist has reduced his staff from ten to six because of the slump in sales. The owner of the rug business, who had built up her company from 35 employees in 2015 to 300 before the collapse of the Republic, now employs 170 people. The problem with downsizing, of course, is that if it is widespread, it dampens demand yet further.

Our interviewees, both those struggling to stay in business and those who are prospering, described the problems they faced, which are explored below.

Weak or collapsed customer demand

Most interviewees described how demand for their goods had fallen since August 2021. This had been the case whether their customers were domestic or foreign, wholesale or retail.

The children’s clothes manufacturer had set up his factory in Kabul five years ago, after years of importing clothes from Pakistan and selling them from a shop in

[8] Safiat, a ‘sanitation tax’, is collected from households and businesses in urban areas and spent locally by the municipality.

Kabul’s Mandawi market. He said he had to lay off staff because of falling demand. The company is scrupulous, he said, in offering what customers need – well-made clothes in appropriate styles using fabrics that are kind to children’s skin. That market research, he said, would normally mean growing sales and increasing profits, but not in the current context of shrinking demand.

> *When people struggle to buy food, how can they think about clothes? For example, if in the past people used to buy clothes for their children every week, now they buy them once a year. In the past, people used to buy every new design on the market, but now it’s not like that. Now, when people buy, they want [clothes made of] good material, but cheap – but that can’t cover our costs.*

Labourers work at a cotton factory in Kandahar.
Photo: Sanaullah Seiam/AFP, 28 February 2024

The importer of crockery and glassware, who buys from Iran and China and sells directly to the public in his shops, and to other retailers, said he used to import eight to ten truckloads of dishes every three months, each containing about 25 tonnes of dishes. This is now down to two or three trucks per quarter. His company has an office, a warehouse and shops in Kabul. They used to send goods to other provinces, such as Maidan Wardak, Balkh, Kunduz, Bamyan and Nangrahar, but not anymore.

> *The business is not going well. People can’t afford to buy, mostly because of the economic situation in Afghanistan. Dishes aren’t a basic need for people. Food and clothes are the basic needs and then come crockery and glassware. People can keep their old dishes and don’t need to buy new ones – only if they’re broken. … I can say that if people had jobs, they could go shopping for dishes, after they’d met their other requirements. When people have jobs, they have enough to eat and buy dishes.*

The herbalist imports some remedies as well as mixing his own medicines, combining raw ingredients sourced from Afghanistan, Iran, Pakistan, and occasionally India. Sales were down, he said, because “the economy is bad.” He cannot pass on his increased costs (stemming from greater taxes and problems with customs and bureaucracy – more on this later) to customers because they cannot afford the higher prices. He was, he said, “tired of doing business” and wondering how to leave Afghanistan.

Deflation

Deflation – when prices fall – benefits individual householders but dampens business investment, economic growth, job creation, consumer demand and efforts to alleviate poverty. It can make doing business extremely difficult, as the trader in onions and potatoes has found.

He buys onions and potatoes from Afghan farmers during the season and otherwise imports them to sell, largely domestically. In the past two years, he said, falling prices have hit his business hard. By the time he gets produce to Kabul to sell on, he said, the price has fallen. He said this has been the main reason he has made “complete losses” and “could not make a profit.”

Cheap imports

The owner of the children’s clothes factory in Kabul said the entry of cheap Chinese goods into Afghanistan had “destroyed domestic production.” Even people who tried to buy Afghan products for patriotic reasons had turned to Chinese ones since the economic crisis because they were so much cheaper. The owner of the pulse processing factory also said it was difficult to compete against cheap imports which were, in his opinion, low-quality. He would like the government to increase taxes on imported pulses, which, he said, would help farmers sell their harvest and allied businesses to flourish. Behind cheap imports is the over-valued Afghan currency. It helps foreign competitors by making imports to Afghanistan cheaper and Afghan exports more expensive.

Other undercutting

The owner of the children's clothes factory described another unexpected threat to his business caused by the economic downturn:

> *Most people make clothes at home because there's a tailor in every family, especially women, because most of them know how to sew. They come [to the shop] and buy one, two or three types of clothing, copy them at home and then sell the copies cheaply, which damages [the demand for] our products. They can sell the clothes cheaply because they have no rent to pay, no taxes, no employee salaries, no expenses, just the cloth from the market. Good for them! They make a living and find the money to cover their daily expenses … but it's weakened our business.*

Taxes

Almost every interviewee complained about high taxes. Yet the Emirate has actually reduced tax rates for the private sector. In 2023, reported the Bank, "the Business Receipt Tax (BRT) rate for industries was halved to 2 percent, small business tax rates were trimmed from 1.5 percent to 0.5 percent, pre-2016 arrears were forgiven, and scaled exemptions were introduced post-2016." It also abolished penalties for overdue driving permits and vehicle registrations and "lowered [customs] duties and valuations in response to trader demands." Yet this is not the picture painted by our interviewees, many of whom spoke about their tax bill having gone up or that they are paying new taxes.

The owner of the factory that processes pulses said high taxes ranked third among the pressures on his business: his company simply does not make enough profit to pay the tax being demanded. "They've increased taxes," said the herbalist. "They tax under different names. In the Republic, if the goods were in the warehouse, there would be no tax on it, but now they tax everything." The clothing factory owner said: "They've increased taxes. They take money from businessmen and traders for business and activity licenses under different names, and it has made life bitter for businessmen." The deputy manager of the pressure cooker factory acknowledged that the government had halved the business receipt tax for companies to two per cent of turnover, but said new taxes added up to more than two per cent. He also said they were under pressure to pay even more:

> *We’ve paid all our taxes on time. But for the second time, they’ve written to our factory, insisting the real tax bill is three times greater. I don’t know if they did this on purpose or accidentally. We reported that we’ve paid taxes, including employee taxes and we owe no money and we pay employees taxes monthly, but we received a letter from the tax intelligence department saying we have to pay our tax bill within a week. Otherwise, it said it would seal our factory, introduce us to the commission, and say we’re evading taxes.*

He said they would have to sell the entire factory to pay the taxes demanded because the amount was so high.

During the Republic, taxes could be avoided or minimised, depending on who one knew and what bribes one paid.[9] Some of the current unhappiness among businesspeople may have to do with now having to pay taxes in full. However, in its latest Private Sector Rapid Survey, which heard from more than 400 firms, the World Bank concluded: “Even with the reduced incidence of unofficial payments [ie bribes], the majority of businesses reported a rise in the overall cost of conducting operations.” It said the Emirate has “intensified its tax collection procedures,” an approach involving “more fully implementing existing regulations regarding income and business taxes.” This also explains an apparent discrepancy – the Emirate has lowered tax rates, but businesses say they are paying more taxes. The Bank echoed our interviewees’ experience, finding that most of the firms it surveyed had reported “an increase in business costs and a greater regulatory burden.”

One tax burden that is certainly new for many since the takeover is *ushr*, a tax taken on the harvest, and *zakat,* taken on an increase in flocks or herds, neither of which the Republic collected. During the insurgency, the Taleban took ushr, especially on the poppy harvest, in areas under their control.[10] It is the main tax affecting the

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[9] For more on this, see Sarajuddin Isar, ‘The Border Business: A Political Economy Analysis of Checkpoint Taxation In Afghanistan’, working paper, DIIS (Danish Institute for International Studies), June 2024, and Kate Clark and the AAN team, ‘Taxing the Afghan Nation: What the Taleban’s pursuit of domestic revenues means for citizens, the economy and the state’, 28 September 2022.

[10] For more on demands for ushr and zakat in today’s Islamic Emirate, see AAN’s September 2022 special report, ‘Taxing the Afghan Nation’, especially pages 18, 22, 23, and 36–38 (see footnote (fn) 9). For more on ushr and other taxes during the insurgency, see the research series featured in our dossier ‘Living under the Taleban’ (see fn 4).

onion and potato trader's business. He said farmers and traders agree between themselves who will pay this tax, but if it is the trader, the farmer gets a lower price for their produce, so the burden is ultimately on them.

Ushr is levied nationwide by the Ministry of Agriculture, with receipts going directly to the office of the Supreme Leader rather than to the Ministry of Finance. The trader said he pays 7,000-15,000 afghanis (USD 82-176) ushr per truck of produce and then, when he gets the load to Kabul, the municipality also takes another 300 afghanis for each tonne. He said that, on average, this works out to 12,000 afghanis (USD 141) deducted from his company's profit for every truck of produce. Rent on the greengrocer shops he runs in Kabul, which belong to the municipality, has also gone up: "In the past, we were paying 3,350 afghanis rent. Now, it's 11,000 [USD 41 to 129]." He called the government's demands for money a "continuous extraction."

Customs

Almost every interviewee who imports goods or raw materials described being at their wits' end over customs, not only because of the amount of duty demanded but also due to the bureaucracy and chaotic systems at the border. This matched the findings of the firms responding to the World Bank's private sector survey: half said clearing goods through customs had become costlier and that, overall, fiscal payment procedures had become more time-consuming than before August 2021.

The herbalist said that, previously, there were no obstacles at customs and goods arrived on time. Now, he said, the duty had tripled and last year, about 300,000 afghanis (USD 3,530) worth of his goods had been lost at customs, although who was responsible, whether the customs or the shipping company, was unclear – neither had taken responsibility.

The owner of the embroidery business named customs as her number one problem. Her company provides materials to women working at home and has to import raw materials from neighbouring countries, mainly Pakistan, because there is no quality domestic source. She said, "The new government has imposed a lot of restrictions on imports and exports and that is why, mostly, our materials don't arrive on time. Sometimes, our goods remain on the way for two or three months." The result, she said, "is so much wasted time."

The deputy manager of the pressure cooker company also said customs takes far too long to process imported raw materials – often a month – holding up their time-sensitive operations. He described bureaucratic delays associated with lots of questions and staff having to go to different places, "making you wander everywhere." In the Republic era, he said, goods were cleared from customs in one day, but now it takes weeks, and if they cannot get the materials to their factory on time, their "work is paralysed." He said exports are equally problematic: "When you export something, millions of questions are also asked, which diverts traders' attention and causes them trouble."

Carpet weavers in a factory in Kabul, Afghanistan.
Photo: Wakil Kohsar/AFP, 20 July 2024

The herbalist said every merchant must register imported medicines with the Ministry of Public Health. "My business is traditional medicine," he said, "which includes more than 100 ingredients and herbs. I can't register all of them." He has drastically reduced the ingredients he imports because "no matter how many different types of ingredients you import, they want to increase the amount of tax, or they don't allow you to import at all." He added that there were no, or very few, laboratories at customs and few professionals working there, so that "most of the drugs we import aren't recognised and are returned."

Under the Republic, as with their tax bills, traders could also pay bribes to reduce customs charges. The loss to the treasury was immense: one 2021 study followed the three-way split of money paid out to officials, insurgents and the treasury from potential customs in Nimruz and concluded that only a quarter of what should have been paid in customs duties was reaching the treasury.[11] Some of the upset with customs may be due to having to pay the duties in full now, although at least for our interviewees, the unhappiness appeared to have as much to do with bureaucracy and inefficiency as money per se.

Restrictions

The businesswoman who set up and registered her own carpet-weaving business in 2015 (she had herself been weaving carpets since the age of five) described a combination of problems, many of which stem from her being female and the absence of a ‘gender level’ playing field.

Mostly, in Afghanistan, she said, it is women who weave rugs, especially since the Emirate restricted them from working in certain sectors. She said many of her workers had been too nervous to come to work after the takeover: “We had to stop for six or seven months because we were afraid. Then, we resumed working.” There was another drop-off in workers when the government banned women from working for NGOs and the UN (in December 2022), even though the order left private enterprises untouched. She had faced losses, she said, but has kept the business going, albeit with difficulty. Her company’s carpets are exported to Pakistan, Europe and America, but she has to do this via “major companies” that deal with foreign orders.

> *Those companies buy our products at somewhat lower prices, so we also have to pay the women working with us lower wages. Those companies, run by men and with foreign customers, are doing very well. They receive orders from abroad and produce rugs or tell other companies like us to provide them and then they export them to their foreign customers.*

It was those middlemen, she said, who creamed off a percentage of the profits, meaning she could not pay her overwhelmingly female workers so much, even though it was the women who were the real producers and hardest workers.

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[11] See David Mansfield and Graeme Smith, ‘War Gains: How the economic benefits of the conflict are distributed in Afghanistan and the implications for peace. A case study on Nimroz province’, August 2021, Overseas Development Institute (ODI), London.

Closed borders

For the potato and onion trader, the repeatedly closed border with Pakistan has meant he has virtually stopped exporting produce. He described one attempt at exporting onions to Pakistan in the month of *Dalwa* (January/February 2024), which ended up with his trucks stuck at the border for 10 to 15 days.

> *[A]lmost half the onions were rotten when we brought them back to Kabul. We lost a lot because we bought one ser [7 kilograms] of onions for 170 afghanis and could only sell them for 70 afghanis. We lost 270,000 up to 300,000 afghanis [USD 3,180 to 3,530] for every truck of onions. In total, I managed to get 15 trucks of onions across the border, but six were returned.*

Most of the onions that returned to the capital, he said, were rotten and unsellable.[12]

Banking and investment

Just two of our interviewees referred to problems with banking; the owner of the children's clothes factory mentioned "banking challenges" without giving any more details, while the deputy manager of the pressure cooker factory said international restrictions had made business activity difficult and forced traders to transfer money via *hawala* (the informal money-transfer system). Those banking restrictions should be removed, he said. He also pointed out that "some special banks" that had given loans to businessmen, enabling them to expand, were no longer lending money: "The government stopped it because [taking interest] is against sharia law."

Access to capital was a more widely mentioned problem. The embroidery business owner cited it as the second biggest issue holding back her enterprise. The carpet-weaving factory owner also described how difficult it was for her to expand her business beyond an "average" size because of a lack of investment and capital. It meant she was dependent on male-owned businesses for finishing (cutting and washing) the carpets and exporting them. As long as she cannot vertically expand her business to both finishing and exporting, she will be trapped into accepting lower prices for her products and, in turn, paying lower wages. At the moment, she said, "women do the most difficult part, weaving the rugs, and they work so

[12] For an in-depth look at the problem of closed borders as it affects farmers in Kandahar – who also speak about other difficulties – see the April 2022 AAN report by Ali Mohammad Sabawoon, 'Crops not Watered, Fruit Rotting: Kandahar's agriculture hit by war, drought and closed customs gates'.

hard," but they can only get low wages. "We need to have other women's companies and factories cutting and washing carpets. That would help the Afghan economy as a whole. It would be great if we had foreign customers and exported our products ourselves and not be dependent on other companies run by men." The clothes factory owner also said he would love to expand his business and export clothes, but lacks the capital to take that step: for now, he says, sales will remain domestic. The herbalist said, "They [unspecified] have narrowed the business space for investors."

Less support than in the past

The trader in onions and potatoes mentioned the support he had previously received from an international organisation. Under the Republic, he said, USAID had helped merchants distribute fertilizers to farmers in the provinces. Such help is often no longer there. Just one of our interviewees, the pulse processing factory owner, had received support since August 2021: after the IEA took power, he said, the International Organisation for Migration (IOM) had covered six months of salaries for his staff and those of many other factory owners to "prevent the factories collapsing." He said he had also been given credit by the Agriculture Development Fund (ADF) to develop domestic agricultural products.[13]

Problematic state services and infrastructure

Unreliable electricity was a problem cited by the deputy manager of the pressure cooker factory, which needs constant electricity and is too costly to operate on generators, as well as the pulses processer, who can run his operation on generators even though fuel is very expensive. The pressure cooker manager spoke of the desperate need for their business to be granted more land by the government; the pulses factory owner said asphalted roads in the industrial park would help his business.

The onion and potato trader described a desperate need for cold storage to even out gluts and scarcity across the seasons. Being able to store Afghan produce, he

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[13] The factory owner stressed that it was not a loan *per se*, but a 'purchase on credit':

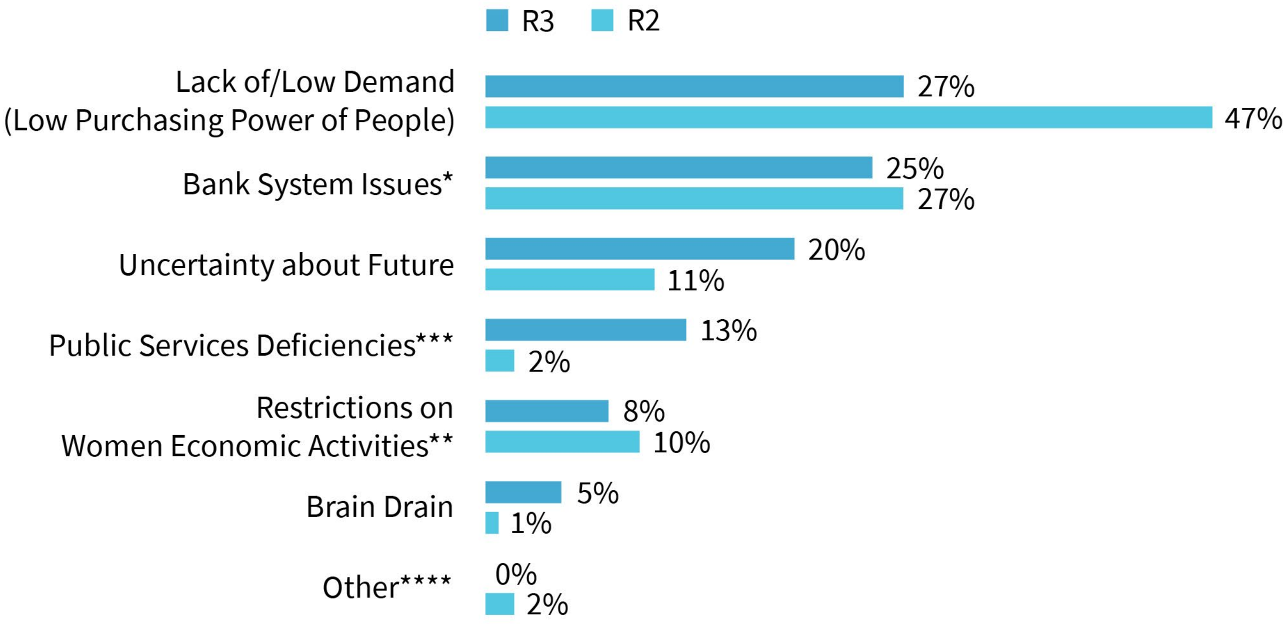
This is my second time taking a loan from the ADF. Actually, the firm doesn't lend to businessmen, it gives money on benefits. I bought an agricultural product of 7.6 million afghanis (USD 108,000). They bought this product and sold it to me for 10 per cent profit. I will have to pay off the loan after 18 months from the date I have bought it. Usually, in the market the people do this kind of business for a 25 per cent benefit.

said, would mean that "traders could sell them when the prices were satisfactory and also that it wouldn't be necessary to import at all… Domestic produce could be sold at good prices to the benefit of both farmers and traders." He gave the example of Jalalabad's onions, which cost him 40-45 afghanis a kilo, but when unavailable, imported onions from Kazakhstan at a cost of 170 afghanis, or Bamyan potatoes that sell for 70 afghanis a kilo; but when they run out, Pakistani potatoes sell for 180 afghanis. "Just compare!" he said. "Is that not a blow!"

Workers make sandals in a factory in Mazar-e Sharif.
Photo: Atif Aryan/AFP, 2 May 2024

A businessman in Kandahar who owns several commercial markets, a centre for moving foodstuffs and a loading centre for heavy trucks, gave an even worse picture than the onion and potato trader when it came to managing domestic agricultural produce. Giving the examples of wheat, potatoes, apples, pomegranates, grapes, melons and watermelons, he said: "Unfortunately, during the harvest season, these products are smuggled to Pakistan and Iran due to the lack of a suitable market and suitable places to store them. So, they are stored in Pakistan and Iran and then exported back to Afghanistan at a higher price during the non-harvest season. They buy at a low price from Afghans and then sell them back at higher prices."

Figure 2: Top constraints reported to the World Bank by businesses



Top three constraints as reported by respondents in round 3 (March 2023) and round 2 (May-June 2022) of a World Bank survey, by percentage.

Source: 'Afghanistan Private Sector Rapid Survey—Round 3', via The World Bank '[Afghanistan Development Update](), April 2024' (see footnote 6).
* "Banking system issues" includes: (i) limited functionality of the banking system; (ii) lack of liquidity/cash; (iii) constraints in access to bank loans or additional funding; (iv) limited functionality of the Hawala system; and (v) lack of funds/grants (eg, from international community).
** "Restrictions on women's economic activities" include: (i) restrictions on economic activities of women; (ii) restrictions on women's employment; and (iii) restrictions on women's movements and appearances in public.
*** "Public services deficiencies" include: (i) electricity blackouts; (ii) higher unofficial payments; (iii) too many taxes on businesses; (iv) low capacity of authorities; (v) restrictions on business license renewal; (vi) lack of enforcement of existing regulations; (vii) lack of caretaker institutions to tackle irregularities; and (viii) lack of policies to support and promote investments.
**** "Other" includes: (i) limited internet access, (ii) lack of information technology (IT) capacity, skills, or technology within the business; and (iii) high prices charged by online platforms, marketplaces, or sellers.

How, after 20 years of development aid, there is still a desperate need for better storage for fruit and vegetables was a surprise to this author. An attempt to answer this question is beyond the reach of this paper, but a 2015 report on 'The Informal Regulation of the Onion Market in Nangarhar, Afghanistan'[14] reveals the complexity of the fresh produce trade, taking the example of onions grown in Nangrahar.

[14] See Giulia Minoia, Wamiqullah Mumtaz, Adam Pain, 'The Informal Regulation of the Onion Market in Nangarhar, Afghanistan', AREU briefing paper, 2015.

The report touches on the lack of cold storage facilities, as well as power relations, social networks, cross-border connections and culinary taste.

A few interviewees alleged corrupt practices among government officials, including the creation of cartels or monopolies to edge competitors out of particular sectors, and demands for bribes. It is difficult to hold up individual allegations or get a sense of whether this is a widespread or growing problem. Given the Emirate has always prided itself on being wholly different from the corrupt Republic, it is a particularly sensitive topic. The World Bank, in its latest Private Sector Rapid Survey said, “corruption has reduced significantly” since the takeover, but even so, just under one-tenth of the firms it surveyed (8 per cent) reported they “had to make unofficial payments or pay bribes to complete business obligations.” Demands for unofficial payments and bribes, the Bank said, “persist[ed] in the process of clearance goods through customs (both for imports and exports) and paying taxes.”

In general, the World Bank’s findings on constraints to business are not dissimilar to the information provided by AAN’s interviewees. Figure 2, above, shows the constraints businesses reported to the Bank in two rounds of a survey, held in May-June 2022 and again in March 2023. Some constraints eased; others worsened.

WORLD BANK REPORTING ON THE ECONOMY AND THE ISLAMIC EMIRATE’S RESPONSE

The World Bank’s macroeconomic data and analysis provide a framework for understanding many of the problems with running a business in today’s Afghanistan, which the businessmen and women have outlined.

The Bank published its latest Development Update in mid-April 2024. In their responses, Emirate officials tried to accentuate the positives about the economy, although in doing so, they praised some dynamics the Bank is concerned about. This section of the report focuses on the Emirate’s responses to some of the immediate takeaways from that update. The report then deals with some of the thornier issues raised by the Bank.

All quotes from the World Bank in this section are from its April 2024 ‘Afghanistan Development Update, Navigating Challenges: Confronting Economic Recession and Deflation’, unless stated otherwise in the text.

This part of the report also draws on the Bank's monthly Afghanistan Economic Monitor, for May, June and July 2024.[15]

A smaller economy, shrunken demand

It was inevitable that the Afghan economy would shrink catastrophically when most civilian aid, military support and spending by foreign armies suddenly ended in August 2021. The World Bank has put some numbers on the magnitude of that lost rent. Using 2019 for comparison – it was the last full year of the Republican government that was also pre-pandemic (during the Covid-19 crisis, both government spending and aid increased) – on-budget and off-budget grants for civilian and security support coming into Afghanistan that year amounted to 616 billion afghanis (USD 7.2 b). Eventually, civilian aid (humanitarian and off-budget) did come back on stream in massive amounts over the winter of 2021/2022. Even so, in 2022, the total was a little less than half what it had been under the Republic, 340 billion afghanis (USD 4 b). It is worth emphasising again that these figures do not take into account the vast sums spent by the United States and other armies in the country. The actual loss of unearned foreign income was far higher.[16]

In those first months of its rule, the IEA managed to take firm control of public finances and the banking system and, by Nawruz 2022, was able to pay civil service and armed forces salaries. That, together with the resumption of humanitarian aid during the winter of 2021/22, eased the economy's freefall. The amount of civilian aid in 2022 was roughly the same as during the last years of the Republic, but without foreign military spending and support to the Afghan security forces, the total amount of unearned income coming into Afghanistan was considerably lower.

The Bank has calculated that GDP shrank by 26 per cent in the two years since the takeover. Acting Deputy Prime Minister for Economic Affairs (unnamed in this RTA report, but presumably Abdul Ghani Baradar) insisted that GDP has increased. Possibly, he was referring to growth subsequent to the initial collapse and contraction. There is indeed now low GDP growth, although GDP per capita is

[15] The World Bank's Afghanistan Economic Monitor, published monthly since October 2021, can be found here.

[16] In 2019, the Republic received Afs 189 billion in on-budget grants. Together with Afs 207 billion of its own revenues, it spent Afs 283 billion on civilian services and Afs 131 billion on security. There was also Afs 427 billion of off-budget support, Afs 274 billion of which was allocated to security and Afs 152 billion to civilian services.

not growing, ie any economic growth is not enough to keep pace with population growth. The fact that the economy is smaller than it was before the takeover appears to be its fundamental problem.[17]

Falling prices

In other responses to the World Bank's analysis, some Emirate officials praised phenomena that the Bank had highlighted as problematic or even hazardous. For example, the Deputy Prime Minister lauded the reduction in prices under the Emirate, ascribing decreases in food and non-food prices to an increase in domestic production.[18] The Bank is acutely worried about deflation, which in May 2024, stood at −7.5 per cent, year-on-year (April 2023 to April 2024), including food at −11.5 per cent and non-food at −3.1 per cent.[19] Core inflation (when more volatile items like food and fuel are excluded) is still registering at −1.5 per cent, indicating, the Bank said, "a lack of sufficient demand for goods and services in the private and public sectors." It elaborated on the risks of deflation in the April 2024 Development Update:

> *While the price decline may alleviate financial burdens for vulnerable households by reducing living costs, it also portends risks for the broader economy. Consumer reluctance to purchase in anticipation of further price declines can deepen economic downturns, reducing production, job losses, and heightened unemployment, thus contributing to recessionary pressures.*

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[17] The World Bank April 2024 Development Update broke down growth/contraction by sector for 2022 and 2021:

The services sector, 45 percent of GDP, contracted by 6.5 percent in 2022, less than the 30 percent decline in 2021. Agriculture, 36 percent of GDP, fell by 6.6 percent due to drought, affecting wheat yields and pastoralists, with harsh winters compounding the impact. The industrial sector shrank by 5.7 percent, with manufacturing down by 10 percent, though less than in 2021, when there was a 12.8 percent drop. Construction declined by 0.8 percent, compared to a 35 percent fall in 2021. Conversely, mining and quarrying grew by 4.1 percent, thanks to increased coal extraction.

18 Part of the Bank's analysis of the impact of the ban on opium cultivation (more on this later in this report) is that "repurposing around 200,000 hectares of land previously dedicated to illicit crops towards food production has led to downward pressure on domestic food prices, albeit at the expense of heightened unemployment."

[19] Figures are from the Bank's June 2024 Monthly Economic Monitor. Deflation began in April 2023, it said, with prices falling at their steepest rate in January 2024, when deflation stood at −10.2 per cent.

“Prolonged deflation,” it warned, further reduces weak consumer demand and makes businesses reluctant to invest. The danger is that “economic growth languishes, impeding sustainable poverty alleviation and job creation.”

The strong currency

Another of the “major [positive] economic indicators” enabled by the Emirate, according to Ministry of Economy spokesperson Abdul Rahman Habib, speaking to Salam Watandar, was “the stability of the value of the Afghani currency.” The Bank, on the other hand, considers the strength of the afghani to be problematic. It makes imports cheaper, which may be good at the household level if it brings down the cost of imported essentials – fuel, medicine and some food. However, it also undermines domestic businesses, whether they are trying to compete with imports made cheap by the strong currency or trying to sell their goods in foreign markets where the strong currency has made them expensive. It therefore amplifies deflationary pressure on the economy.

The afghani did lose value between January and May 2024, according to the Bank, and has appeared to stabilise at a lower rate, around 71–72 afghanis to 1 US dollar. However, this is still 20.7 per cent higher than the rate just before the takeover. As to why the afghani is weakening, the factors all indicate pressure from wider economic or fiscal problems – the growing trade deficit, reduced aid and the insufficient reserves held by Afghanistan’s central bank to cover the government’s budget deficit (more on this below).

Other measures of success cited by the Emirate

Ministry of Economy spokesman Abdul Rahman Habib singled out various other factors as evidence for “real progress and economic mobility” under IEA rule (quoted by Salam Watandar):

> *[T]he increase in national income [domestic revenue], the increase in exports, covering normal [government] expenditure and implementing development projects out of domestic revenues without foreign aid.*

The acting Deputy Prime Minister for Economic Affairs (unnamed, but presumably Baradar) elaborated on this, as reported by TOLOnews:

> *There’s been considerable progress in reducing the trade deficit, for example, we can say that in 1400 [21 March 2021 to 20 March 2022], the value of exports was around 850 million dollars, but in 1402, the level of exports reached two billion dollars, and the amount of imports was also lower, mainly because of an increase in the domestic production of food and non-food items. In addition, the Islamic Emirate has provided job opportunities for hundreds of thousands of people in the fields of mining, infrastructure, industry, agriculture and other fields, a clear example of which is the opening of nine infrastructure projects worth 5.16 billion afghanis [USD 60.7 million] in the month of Hamal in 1403 [21 March to 20 April 2024].*

Abdul Latif Nazari, described in another TOLOnews report as “a professional deputy at the Ministry of Economy,” was quoted as calling the World Bank report “incomplete.” The Islamic Emirate, he said, had taken “serious steps in supporting the growth of domestic production, developing trade and transit, strengthening national monetary stability, launching major economic projects, and also strengthening Afghanistan’s agriculture.”

It is certainly a complex picture: some of what the officials say is true, although with a lot of ‘yes, buts’, as closer scrutiny of several aspects of the economy shows. For example, providing jobs in certain fields, something the deputy prime minister lauded, has not compensated for the overall loss of jobs since the takeover. Employment is “substantially below pre-August 2021 levels,” said the Bank, with both “high unemployment, and underemployment.” The downturn has also driven many households to add members to the workforce (older boys taken out of school to work, women doing paid work, largely in the home), meaning there are more people seeking jobs and trying to earn some marginal income, “exacerbating unemployment amidst limited job opportunities.”[20]

Other aspects of the economic picture are particularly complicated and are looked at in greater detail below.

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[20] The World Bank’s ‘Afghanistan Welfare Monitoring Survey, Round 3’ (see fn 7) tracked rising numbers of primary school-aged children in education (because of better security), but falling secondary school enrolment because of boys being taken out of school to work and girls banned from education. It also tracked higher numbers of women working, typically in the home-based production of food stuffs, textiles or garments, presumably for marginal benefit.

Imports, exports, the trade deficit and a transit trade scam

One intricately knotted set of issues surrounds international trade, the currency and customs revenue. Emirate officials are correct in saying that exports are higher now than they were under the Islamic Republic. 1401/2022 was a record year for exports. According to the Bank’s October 2023 Afghanistan Development Update, Afghanistan exported USD 1.9 billion worth of goods in 2022, far higher than the five-year average for 2016–21, which was just USD 0.8 billion.

A worker assembles air coolers at a workshop in Kandahar.
Photo: Sanaullah Seiam/AFP, 3 June 2024

In 2023, the value of exports was virtually unchanged (a rise of 0.39 per cent compared to 2022). However, exports of the important commodity coal fell by 46 per cent (from USD 476 million in 2022 to USD 257 million) in 2023 and, according to the Bank’s May Economic Monitor, by 84 per cent in the first quarter of 2024 compared to the first quarter of 2023 (USD 17.8 m to USD 11.7 m). Pakistani demand for Afghan coal shrank as it lost its price advantage, with Pakistani importers shifting back to their traditional suppliers. Even though exports of food and textiles did increase somewhat over that period (from USD 354 million to USD

370 million), the major decline in coal exports drove down the total value of Afghan exports.

The strength of the afghani, said the Bank, has “rendered Afghanistan’s exports pricier on the international market, diminishing their demand and undercutting Afghanistan’s export sector’s potential to catalyse economic growth in the post-conflict landscape. It is also adding to the widening trade deficit.”

As to imports, they are lower than under the Republic, unsurprising given the contraction in consumer demand. However, astonishingly, they surged in 1402/2023 by 23 per cent to USD 7.8 billion, despite the still-shrinking economy and weak consumer demand. The Bank explained most of this by estimating that “approximately one-fourth of Afghanistan’s imports were actually destined for Pakistan, paid for by Pakistani importers.” The Bank scrutinised the considerable surge in imports of goods thought largely to be destined for re-export to Pakistan: machinery, transportation goods and chemicals saw a remarkable 59.3 per cent growth in 1402/2023 compared to 1401/2022. It also noted that imports of primary goods such as food, textiles, and minerals had also increased, but by far a smaller amount, 11.6 per cent in 1401/2022 compared to 1402/2023 (see Figure 3A below).

For almost a year after September 2022, when Islamabad put curbs on imports to try to conserve foreign currency,[21] there was an increased incentive for Pakistani businesses to route imports via Afghanistan. In many cases, this was done by using international trade rules whereby goods destined for land-locked Afghanistan can enter Pakistan customs-free (the Afghanistan Transit Trade), but still pay customs when they enter Afghanistan. If goods are then illegally (re-)exported to Pakistan, again without customs, they undercut the prices of goods legally imported to Pakistan. However, in August 2023, Islamabad lifted the import curbs for its traders (see reporting by Reuters) and in October 2023, Pakistan initiated extra safeguards and a ban on certain goods, which they had identified as typically being imported to Afghanistan customs-free and then smuggled back out to Pakistan.[22] Islamabad also imposed a 10 per cent tariff on all goods transiting to Afghanistan from Pakistani territory (see media reporting here). The repercussions are not yet clear, but if

[21] In May 2022, Islamabad put an outright ban on the import of certain items. Pakistan’s central bank also implemented a ‘go-slow policy’ on measures such as opening import letters of credits, all in an effort to manage its balance of payments problems and shrinking foreign currency reserves.

[22] The goods identified as primarily being re-exported from Afghanistan to Pakistan included 17 types of clothing, all types of vehicle tyres, tea leaves, cosmetics and dozens of toiletries, totalling 212 items.

imports destined for re-export to Pakistan do fall, it could reduce government customs revenue.

Figure 3A: Changing imports shares

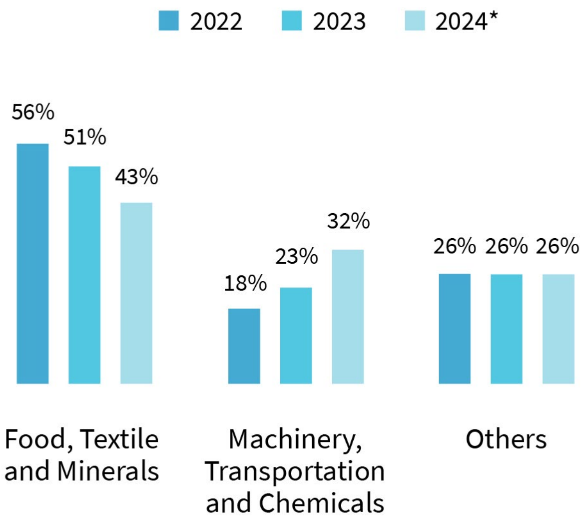
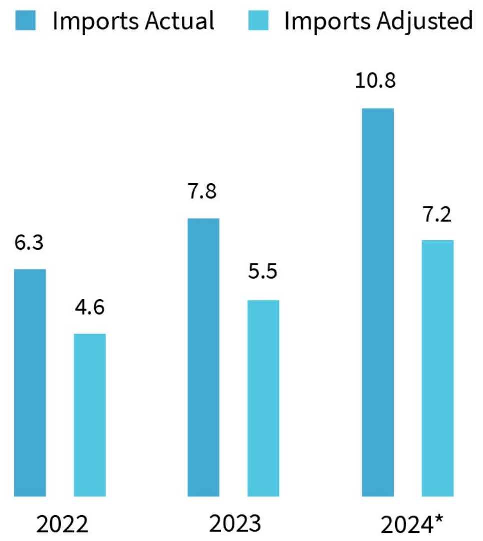


Figure 3B: Actual and adjusted imports



Source: The World Bank ‘Afghanistan Development Update, April 2024’, calculations based on data from the Automated System for Customs Data (ASYCUDA).
* The 2024 value is simulated based on the January 2024 value of exports and the 2023 seasonal pattern.

As can be seen in Figure 3B above, the Bank adjusted the import figures for 2023, removing those it believed to be ultimately destined for Pakistan. It calculated that Afghanistan’s real imports might be closer to USD 5.5 billion, rather than the USD 7.8 billion recorded in the accounts. That would still give a sizeable actual trade deficit of around USD 3.6 billion in 2023. This, the Bank said, would have been covered by the United Nations bringing dollars into the country to pay for civilian aid – approximately USD 1.8 billion a year – and by remittances – around USD 2 billion.

Even after the adjustment, real imports were clearly still greater in 2023 than in 2024, a reflection of how the overvalued afghani makes imports cheaper and domestic production less competitive.

The strong afghani and shrunken money supply

Several factors have boosted the afghani. The authorities have kept a tight control on capital flight, including preventing dollar smuggling and banning the use of foreign currency for domestic transactions, thereby preserving the supply of dollars while boosting demand for afghanis. The UN's monthly shipments and remittances and the surge in imports destined for re-export to Pakistan have all ensured a good supply of dollars flowing into the country. At the same time, says the Bank, demand for afghani banknotes has been bolstered because they are in such short supply; they must be printed outside the country and, although consignments of new notes have been allowed, the process is more laborious than if there were no sanctions.

The Bank estimates that Afghanistan's money supply, counting both afghanis in circulation and bank deposits, shrank by 11 per cent (over two and a half years, between the 4th quarter of 2020 and the 2nd quarter of 2023). It blamed "sanctions, frozen assets, banking disruptions, domestic payment system issues, and a shift to Islamic banking." The country's "inability to mint new currency, compounded by sanctions that prevent replacing old banknotes ... further tighten[ed] the money supply. [23] This dynamic is helping to over-value the afghani, it said, but also:

> *Lower currency in circulation has limited access to credit for consumers and deterred spending, while businesses encounter obstacles in securing investment loans. Consequently, this is dampening demand for goods and services, prompting businesses to lower prices to attract customers, exacerbating deflationary trends.*

The weakness of the banking sector

The adjective used by the Bank to describe Afghanistan's banks was "frail." That weakness is both a function of economic problems and a contributor to them. Almost three years after the change of government and more than two years after multiple waivers were made to United States sanctions, even though most international transactions are now permitted, they remain difficult, costly and

[23] This is the money supply called M2, which is defined as cash in circulation plus money held in savings bank accounts or which can be withdrawn 'on demand'.

often, in the end, impossible. Correspondent banks fear being taken to court by a future US government for breaking sanctions, and that has made them highly risk-averse when dealing with any person or entity inside Afghanistan or even with entities outside the country, which have ‘Afghan’ or ‘Afghanistan’ in their name. This, along with the reduced money supply, has brought about a scaling back in lending, greater dependence on cash and a strong trend toward making payments via hawala rather than through banks.

Freight trains from Uzbekistan stop at the border station in Hairatan, Balkh province, where, every day, workers unload 3,500 tonnes of flour and 1,500 tonnes of wheat from the trains by hand.
Photo: Atif Aryan/AFP, 5 March 2024

Quoting its latest survey of the private sector, the Bank said three-quarters of the firms surveyed had bank accounts, but only just over one-quarter had made deposits since August 2021. “This trend,” said the Bank, “was more pronounced among small and medium-sized enterprises, which have increasingly operated on a cash basis compared to larger firms. These findings highlight the persistent confidence issues within the sector since early 2021.” The survey indicated that 89 per cent of the firms used cash for domestic payments, 32 per cent used hawala and only 13 per cent used the banks.

External pressures

As the problems facing the banking sector make clear, Afghanistan’s government is not in control of all factors affecting the economy. Afghanistan is in large part unmoored from the international banking system and excluded from development aid, loans and climate change funds. The Bank blames the lack of on-budget support on the IEA’s “stance on human rights, gender, and inclusion.” Whether it is intransigence by the Emirate or by Western donors and the nations of the world who have not hurried to either recognise the Afghan government or press for sanctions to be lifted, these barriers make it far harder for the IEA to manage the economy.

Emirate officials responding to the World Bank’s report did indeed blame economic problems on the international context. Acting Deputy Minister of Economy Abdul Latif Nazari told TOLOnews that, “sanctions and restrictions on the people of Afghanistan [had to] be urgently lifted.” State broadcaster RTA, citing the Deputy Prime Minister for Economic Affairs, reported that, “if the international community engages in positive interaction, removes the sanctions and frees the country’s blocked assets, and cooperates in financing development projects in various sectors, as a result, new job opportunities will be created and the economic situation of the country will be improved.”

Public finances: taxation

However, there are aspects of the economy over which the IEA does have greater control. One of these is public finances – revenue collection and spending. The Bank’s Development Update, published in April 2024, said that total revenues had risen by 9 per cent in 1402/2023 (that is, the 12 months preceding 20 March 2024) compared to 1401/2022, surpassing the target the government had set itself – something which various officials pointed to as a positive in their responses to the World Bank report. The increase was mainly due to ‘non-tax revenues’, a category which includes income from the mining sector and customs receipts: the latter grew by 5 per cent in 1402/2023, “propelled by greater trade volume and enhanced collection efficiency.” Inland revenues also increased by 13 per cent, a result, said the Bank, of “tax rate cuts [not explained, but possibly this encouraged greater compliance], stricter compliance, and tax base expansion."[24] The Bank's report makes no mention of ushr or zakat, the taxes taken on harvests and increases in flocks and herds, which are collected by the Ministry of Agriculture and sent directly to the office of the Amir.

The IEA has, in general, proved far more effective at collecting revenues than the Republic. Under the Republic, large amounts of taxes, customs and other income never reached the treasury (see previous AAN reporting on taxation, footnote 9, for more details). With a far smaller economy, the IEA has so far managed to raise similar amounts to the Republic: USD 194 billion in 1401/2022 and USD 210.7 billion in 1402/2023–24, compared with USD 203 billion in 2019.

However, some of that revenue looks less certain in the future. Unpaid back taxes, which boosted revenues early on after the re-establishment of the Emirate, will eventually all be paid, and some business taxes, as were seen, have been forgiven. Customs revenues might decline if Pakistan eases its curbs on imports, resulting in fewer goods being routed through Afghanistan. "Heavy reliance on customs revenue," warned the Bank, "may be precarious as trade policies and consumer patterns shift, and changes in trading partners' preferences, like the coal trade with Pakistan, could also influence border tax earnings."

Public finances: spending

One factor totally within the government's control is how it spends those revenues. Since taking power, the Emirate has been reluctant to release information about public finances, especially spending. However, the Bank released some details about

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[24] The June Monthly Economic Monitor gave some more recent figures and a somewhat more mixed picture:

After achieving the revenue target of AFN 210 billion in FY 2023–24, the first two months of FY 2024–25 experienced a decline in revenue mobilization, primarily due to reduced border taxes. During this period, Afghanistan's total revenue reached AFN 31.2 billion, reflecting a modest year-on-year growth of 0.7 percent but falling short of the target by 8 percent.

Customs revenue decreased by 13 percent year-on-year to AFN 16.7 billion. However, a significant recovery occurred in May, with customs collections increasing by 19 percent compared to the previous month, driven by higher import volumes. On the other hand, Inland Revenue saw a robust increase of 22 percent year-on-year, reaching AFN 14.4 billion in the first two months, bolstered by strong performances from Mustofiats [Provincial Departments of the Ministry of Finance], STO [Small Tax Office], and the Audit Department. Despite this, the Afghanistan Revenue Department [inland taxes] collected 13 percent less than the target, and the Afghanistan Customs Department fell short by 3 percent, resulting in overall revenue being AFN 2.7 billion below the target in the first two months.

1402/2023 spending in its April 2024 Development Update and May 2024 Economic Monitor. Total government spending, it said, had been 229.2 billion afghanis (USD 2.7 b), which was 10.7 per cent higher than in 1401/2022. The increase, it said, was mainly due to higher wages and an increase in the *tashkil* (the planned workforce).

The April 2024 Development Update said line ministries had "exacerbated spending pressures by hiring additional staff, leaving many without compensation" and that the IEA's postponement of pension payments for the third year[25] had "contributed to the accumulation of arrears, including unpaid amounts to past development project contractors." In research carried out in 2023, this author had already noted increases in the tashkil as reported in the Emirate's 2023 annual accountability sessions: most notable was the planned increase in the army, from 150,000 personnel in 2022 to 170,000 in 2023 with a further increase planned for 2024 to 180,000.[26] Anecdotal evidence, the Bank reported, suggested that arrears from the previous administration amount to approximately 180 billion afghanis (USD 2.1 b), with 37 billion afghanis (USD 435 m) in pension arrears and a backlog of contractor payments. The government's arrears, it said, "are nearing its annual revenue collection."

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[25] Since the Bank's April 2024 Development Update was published, the IEA has decided to abolish government pensions. For more on this, and the struggles of pensioners who have not been paid since the change of government, see AAN's May 2024 report, 'Where Are My Rights? Afghan retirees appeal for their pensions' by Ali Mohammad Sabawoon.

[26] In the summer of 2022 and 2023, the IEA's ministries and agencies presented information about their work in an accountability initiative pioneered by the second Ashraf Ghani administration. The sessions, from both the Emirate and Republic, can be viewed on the Government Media and Information (GMIC) YouTube channel. In the 1402/2023 sessions, various other ministries and bodies, apart from the Ministry of Defence, detailed increases in staffing (see also this AAN report):

- Ministry of Education: no information on total number of staff or whether there were increases or not in schoolteachers, but did report in 2023 that it had created 100,000 new positions in madrasas;
- Ministry of Public Health: 111,109 staff with approval for 500 new posts;
- Ministry of Hajj and Awqaf: 2,200 new religious employees and 370 new non-religious employees and contractors (tashkil of 9,870 staff, of whom 7,736 were religious workers – khatibs, imams, muezzins and mosque cleaners);
- Ministry of Martyrs and Disabled: 883 posts added which would equate to 1,969 staff in total (in 1401/2022, staffing was reported to have increased from 638 to 1,086);
- Ministry of Public Works: 2,637 staff, compared to 2,185 staff reported in 1401/2022;
- Transport and Aviation: 4,450 staff, compared to 2,339 staff reported in 1401; and
- Academy of Sciences: 521 staff (304 scientific; 118 administrative, professional or technical; 99 service staff), including 50 new posts.

Increased spending in 1402/2023 left a budget deficit of 18.4 billion afghanis (USD 2.6 m). It was covered, as in previous years, according to the World Bank's May Economic Monitor citing "anecdotal information," from "treasury cash reserves left over from the republic era." The Bank warned:

> *This spending pattern places the country on an unsustainable path, as it exceeds the actual revenue-generating capacity and the [Interim Taleban Authority] lacks the actual other borrowing options to finance its deficits. The only viable strategies are to increase domestic revenues or cut unnecessary spending.*

The Bank, in its Development Update, said the IEA continues to prioritise spending on police, army and intelligence over "essential social sectors, such as health and agriculture, thereby potentially compromising social protection mechanisms."[27] The sums are staggering: 97 billion afghanis (USD 1.14 b) or about half of the IEA's budget in 1402/2023 went on 'security' (this is broken down in the May Economic Monitor into 27 per cent of the budget going on defence (an increase of 7 per cent compared to spending in 1401/2022) and 20 per cent on 'public order and safety' (an increase of 41.9 per cent).

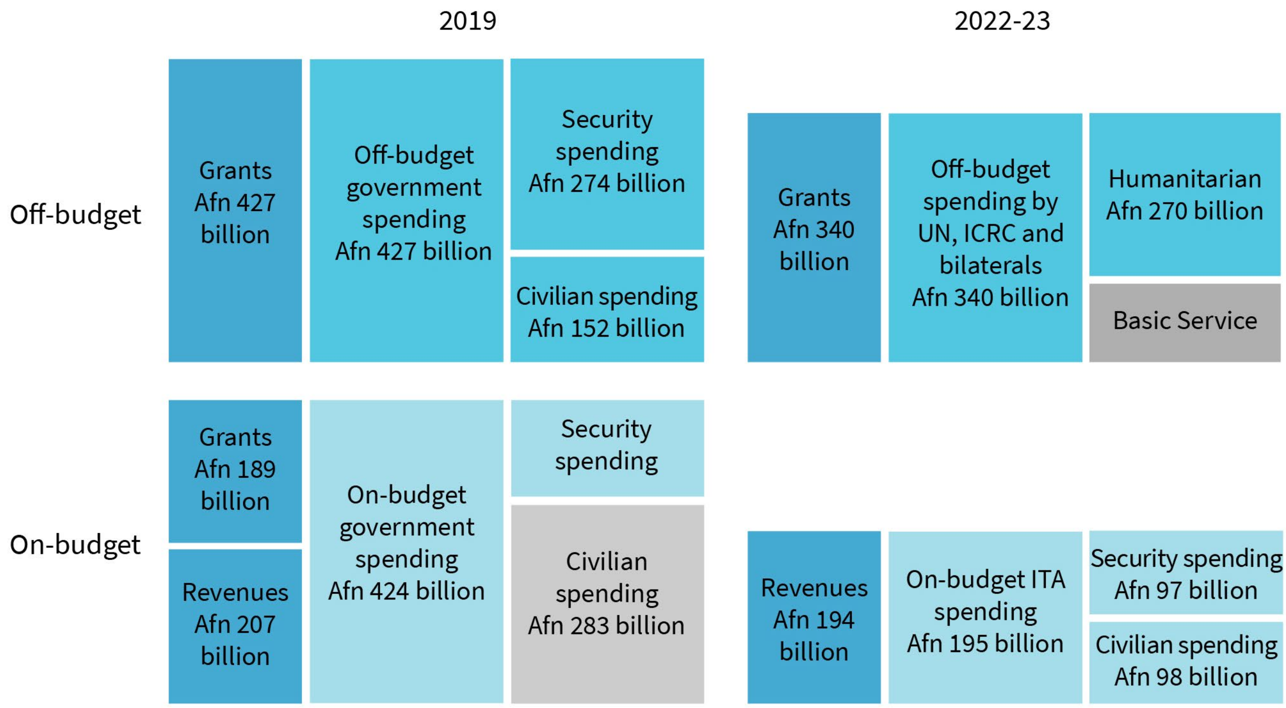
The civilian sector with the biggest share of the budget in 1402/2023 was education (including higher education), which received 18 per cent of spending. 'General public services' received 9 per cent; social protection 6 per cent; economic affairs 5 per cent (up by 80 per cent); and health 2 per cent (an increase of 43.7 per cent compared to the year before). As in previous years, the bulk of expenditure (92.2 per cent) went on operational costs, an increase of 7.6 per cent, with 70 per cent going on wages and salaries. 7.8 per cent of expenditure was spent on development, an increase of 67 per cent. The single biggest development expenditure was constructing the Qush Tepa Canal (5.5 billion afghanis/USD 64.7 million). The Bank said the development budget for 1402/2023 was 30 billion afghanis (USD 352.9 m), but only 17 billion (USD 200,000 million) were spent. It does not say why.

In their response to the World Bank's Development Update, officials pointed to the IEA's success in covering services with domestic revenues, unlike the Republic, which relied heavily on foreign on-budget aid. However, civilian aid still supports some of those services (although nothing like on the scale seen during the Republic). Out of a total of 340 billion afghanis (USD 4 b) in civilian aid in 1402/2023, the Bank said 240

[27] The World Bank has had greater access to information about the budget than Afghan citizens have been given.

billion afghanis (USD 2.8 b) went to humanitarian aid, while another 70 billion (USD 823 m) was spent on basic services, “especially in healthcare, education, and water management, targeting pro-poor outcomes.” Total spending by what the World Bank calls “bilaterals” – the UN, International Committee of the Red Cross (ICRC) and NGOs – was higher than total Afghan government spending in 1402/2023 – 340 billion afghanis (USD 4 b), compared with 195 billion afghanis (USD 2.3 b) by the IEA. Of that total government spending, only 98 billion afghanis/USD 1.15 billion went on civilian services.

Figure 4: A comparison of Republic and Emirate revenue and spending



Source: AFMIS, Ministry of Finance, and UN via World Bank ‘Afghanistan Development Update, April 2024’.

An overall comparison of revenue and spending under the Republic in 2019 and the Emirate in 2022, broken down by on and off-budget, civilian and security, domestic and grants, can be seen in Figure 4 (taken from the World Bank Development Update). It shows how much less money the Emirate has to spend compared to the Republic, but also the Emirate’s prioritisation of spending on the security sector and the continuing importance of aid to civilian services.

Provision of public goods and services by international organisations is inefficient, costly and far less sustainable than when a government provides them. The current practice stems from donors’ reluctance to provide direct support to the Emirate.

However, cost and inefficiency are not the only problems: international civilian aid is declining and that will impact basic services, says the Bank, unless the Emirate reallocates spending away from security to compensate for the loss.

Given the magnitude of the aid and its importance in creating demand, supporting the afghani, paying for imports, providing jobs and so on, any reduction will also have a sizeable impact on the macro-economy. (For more on this, see US Institute of Peace (USIP) and former World Bank economist, William Byrd's March 2023 analysis, '[Afghanistan Requires a Change from Humanitarian Business as Usual](#)'.)

The budget for the current fiscal year, 1403/2024, was passed two months into the new Afghan year, on 21 May 2024. The Ministry of Finance's announcement that Supreme Leader Mawlawi Hibatullah Akhundzada had given his approval provided only a few sentences of information – that government spending would all come from domestic revenues, that the needs and priorities of the people had been considered and that spending had increased.[28] This is a marked downturn in transparency, even compared to earlier years of IEA rule. Unlike the Republic, which, in the matter of public finances, was very open, publishing a budget document hundreds of pages long in its latter years, the Emirate has published just one three-month 'mini-budget', which covered the last three months of 1400 (December 2021 to March 2022).[29]

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[28] A thread of three tweets (translated from Pashto, punctuation as original) published by the Ministry of Finance on 21 May 2024, said:

The national budget document for the fiscal year 1403 has been approved

The national budget document of Afghanistan (1403) has been approved by the leader of the Islamic Emirate of Afghanistan, Amir al-Mu'minin Sheikh al-Hadith Mawlawi Hibatullah Akhundzada (may God protect him) after thorough and careful consideration.

The national budget for the current financial year has been prepared from domestic revenues, and the people's needs and priorities have been widely considered. Like last year's, it has been prepared based on domestic revenues.

The Ministry of Finance, as always, will place the national budget of the financial year (1403) in the country's financial system and will continue, God willing, with all the affairs related to the current financial year (operational and developmental) in a normal manner and with full transparency.

See also this brief line from government spokesman Zabiullah Mujahid to RTA on 22 May 2024; he said that both the operational and development budget had increased.

[29] See two papers by AAN that sought to analyse the information that had been released, including in the 1400 mini-budget (December 2021-March 2022), World Bank reporting and accountability sessions held in the summer of 1401/2022 and 1402/2023: 'What Do The Taleban Spend Afghanistan's Money On? Government expenditure under the Islamic Emirate' and 'Survival and Stagnation: The State of the Afghan economy'.

Quoting unofficial sources in its May 2024 Economic Monitor, the Bank said the 'budget ceiling' for 1403/2024 had been set at 325 billion afghanis (USD 3.8 b). That would be a leap in spending – 41.8 per cent higher than in 1402/2023 when 229.2 billion afghanis (USD 2.7 b) was spent. The lateness of the Ministry of Finance's announcement for the 1403/2024 budget suggests possible disagreements between ministries over allocations, while the fact that there has been virtually no public information, not even ball-park figures for revenue and spending (as in 2023), perhaps suggests that citizens, if they knew more, might not be happy to know where their money is spent.

The opium ban

Another policy the government has control over is how it deals with the country's opium economy. The ban on opium cultivation, announced in April 2022 and implemented in the next sowing season in autumn 2022, has caused what the World Bank estimates to be a loss of USD 1.3 billion to farmers' incomes – equivalent to about 8 per cent of GDP – as well as 450,000 jobs at the farm level (figures from the United Nations Office on Drugs and Crime (UNODC) quoted by the Bank).[30] The impact of the ban is complicated by inequality in landholdings and whether individuals have had access to opium stocks.

Opium paste stores well and reports suggest its trade has continued despite being officially banned.[31] An April 2024 report by David Mansfield and Alcis calculated how much better off richer farmers and those with large landholdings in opium-growing areas are. With inventory to sell, they have done well out of the ban as opium prices skyrocketed. Compared to these windfall profits, the landless and land-poor – many of whom used to benefit from the many seasonal jobs provided by opium cultivation – are now struggling to pay for food and healthcare (see this March 2024 report from AAN, which heard from farmers in Helmand hit hard by the ban on cultivation).

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[30] By contrast, the earthquakes in Herat province in October 2023 (see Roxanna Shapour's 10 November 2023 report for 'Nature's Fury: The Herat earthquakes of 2023'), which killed thousands of people and damaged infrastructure and livelihoods, reduced GDP, said the Bank, by about 0.5 to 0.8 per cent. The forced return of Afghans, especially the more than half a million people from Pakistan in 2023, will also have added to the burdens on the economy, but this is a harm that is beyond government control.

[31] For sources, including UNODC, on how trade continues, see AAN's 15 November 2023 report, 'Prosperity or Penury: The political and economic fallout of the opium ban in Afghanistan'.

Tailors sew clothes at a shop in Faizabad district, Badakhshan province.
Photo: Omer Abrar/AFP, 23 July 2024

Poppy income has always been so large that there are national implications to any ban: opiates have generally brought in the equivalent of around 10 to 15 per cent of Afghanistan’s licit GDP (see AAN reporting here). The Emirate also stopped taxing opium in spring 2023, off the back of the official ban. While jobs relating to poppy will now be seriously reduced – most paid work related to opium was in cultivation, not trade – and profits are far more skewed towards the already wealthy, the fact that opium exports continue will support the macro-economy, helping to pay for imports and boost GDP and demand.

LOOKING AHEAD

The fundamental problem for the Afghan economy is that it is far smaller than it was before the Taleban takeover, “a staggering 26 percent” smaller in terms of real GDP, according to the Bank. Much of what has happened subsequently is the pain of an economy readjusting after being pumped up with rent, the magnitude of which was unparalleled in the world. The economy is still trying to find its equilibrium after that drastic, sudden and unplanned-for slashing of rent and come to terms with what had been huge rent-induced distortions – artificially high demand, high wages, high prices, an over-strong afghani, cheap imports, expensive exports and weakened domestic production.

Whoever had been in power and whatever the nature of their government, overseeing the abrupt economic transition could not have been done without consequences in terms of businesses shutting, unemployment soaring and households thrown into poverty. The Emirate did better than the Republic probably would have done in the same circumstances, swiftly moving to use the bureaucracy and systems of the state it had suddenly inherited to collect revenues, bring them to the centre and pay salaries. This, along with the move to restart humanitarian aid, did rescue the economy from further ravages. However, doing more than just surviving is a tall order, given the economy’s structural problems in that it is not only far smaller but also cut off from development aid and funds to mitigate climate change damage, as well as facing huge hurdles in dealing with the international banking system.

Long-term economic growth, said the Bank, will rely on shifting from “reliance on international aid and consumption-driven growth to a more resilient, private sector-led economy.” How to get there is the question.

The Bank has said, quite baldly, that Afghanistan has no “internal engines of growth” and with “no policy levers to stimulate aggregate demand, the economy remains stagnant, with low demand driving a noticeable deflation.” It offers only “glimmers of hope” in Afghanistan’s comparative advantages in agriculture and mining, adding: “Strategic investments in irrigation infrastructure, land tenure security, research and market access are essential to enhance agricultural productivity and resilience.”[32] The Emirate is far more optimistic, pointing especially to mining and to Afghanistan’s geographical position at the ‘crossroads of Asia’. If Afghanistan could only throw off the shackles of sanctions, officials argue, take back its frozen assets, and have its government recognised, it would be able to trade freely and really grow its economy.

For as long as the situation vis-à-vis sanctions and other restrictions remain unchanged, are there measures the Afghan state can take now to create a more conducive environment for private enterprise?

Greater security and the end of the conflict were cited by many of our interviewees as a fundamental precondition for doing business and something they were positive about. However, one must wonder whether the Emirate needs to spend half of all public expenditure on the wages of police and soldiers. Expanding the government’s tashkil puts ever greater pressure on those paying for it, for example, through taxes or how customs duties are reflected in higher prices for imported goods or goods with imported components. Taxing citizens hard, whether they are businesspeople, householders or farmers, is especially difficult to justify when a relatively small proportion of revenues is spent on civilian sectors, especially those which would have a multiplier effect on the economy (for example, agriculture or infrastructure) or help maintain productivity and be an investment in Afghanistan’s long-term human capital (such as health, higher education and social protection).[33]

Those analysing taxation[34] have noted how, in August 2021, the Emirate was immediately much more effective than the Republic in revenue collection, with more money reaching the treasury rather than officials’ pockets (and, at that

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[32] However, see the 2019 AAN paper by guest author Adam Pain, ‘Growing out of Poverty? Questioning agricultural policy in Afghanistan’ for a critique of how this has been tried before with little success. Pain wrote:

This report argues that agricultural policies in Afghanistan since 2001 have been selectively based on earlier examples, mainly from Asia, of technology driven and market-supported agricultural reforms. These past examples have little in common with the conditions of Afghanistan today, and the assumptions made in these policies take little account of the evidence from Afghanistan’s agrarian economy. Agricultural policy in Afghanistan has clearly failed to deliver on its objectives given the near constant rise in rural poverty rates.

[33] The Ministry of Education, whose work can be seen as aiding productivity and boosting human capital in the long-term, is one of the top three spenders, after the Ministries of Defence and Interior.

[34] Those analysing Emirate taxation have included David Mansfield in ‘Changing the Rules of the Game: How the Taliban Regulated Cross-Border Trade and Upended Afghanistan’s Political Economy’, Alcis, July 2022 and this author, in September 2022, ‘Taxing the Afghan Nation’ (see fn 9).

time, the insurgency). However, businesspeople appear to be feeling increasingly weighed down by the various types of taxes and duties. This highlights a risk in the Emirate’s management of its public finances: in trying to maximise domestic revenue to run the administration, it may be dampening the very private enterprise it extols as the engine of the Afghan economy, as well as further reducing consumer demand. The deputy manager of the pressure cooker factory was not alone in painting a picture of conditions that all too often hinder enterprise. His is the sort of business that is particularly valuable to Afghanistan as it manufactures and exports, creating wealth and jobs. Uncooperative customs officials, unreliable electricity, insufficient land and what he saw as unrealistic and unreasonable tax demands were all a drag on business. They are “slowing down our work,” he said.

The interviewees had several suggestions for what would help them, many of which had to do with what the state could do (albeit with consequences in terms of lowering revenues or increasing costs): freezing taxes, lowering taxes, tax exemption on investment, reducing customs duties, increasing the efficiency of/ reducing bureaucracy and confusion at customs, a reliable electricity supply, support to farmers (including better cold storage facilities for fruit and vegetables), and improving international relations. Like many of our interviewees, the maker of pressure cookers also took a wider view:

> *Now that the security in the country is good, there’s a good opportunity for Afghan traders abroad to come and invest in their own country. On the one hand, they’d develop their country and, on the other hand, support their people so they can get jobs and stop emigrating. Of course, the country’s economic situation is improving compared to two years ago. The most important thing for a trader or industrialist is security, which is currently provided. Second, the current government’s relations with neighbouring countries are very good and improving every day. However, until the fundamental and political problems with the world are solved, the existing trade barriers cannot be removed. There will be problems for businesses, especially if the banks are not freed and the Islamic Emirate is not recognised. Due to recent political developments, some countries don’t easily grant visas to businessmen and they face serious problems in transferring money from Afghanistan to other countries and vice versa.*

Several of our interviewees imagined a more virtuous circle of economic activity. “For example,” said the maker of children’s clothes, “if an engineer has a job in his speciality and his life goes well, he can buy whatever he needs for his family.

His money will circulate [as he buys things] and will strengthen businesses and production, in general, will increase. Each element is linked to the other and [if one is boosted] the entire economy will prosper.” At the moment, though, the Afghan economy seems in danger of the opposite, a vicious circle: for most of our interviewees, reduced customer demand is an ineluctable difficulty. Together with all the other problems outlined in this report, this makes it hard to survive, at least without laying staff off, which, in turn, drives down consumer demand even further.

Changes that would help economic growth include international recognition of the Islamic Emirate, an end to sanctions and a freeing up of banking transactions, a switch from humanitarian to development aid, the lifting of restrictions on out-migration, an end to restrictions on women’s work and female education, an end to the Emirate’s prioritisation of the police and army, and a switch to using more revenue to support the economy or public goods. Every single one of these options is highly political and would involve the Emirate or donors backing down on principled positions, or difficult domestic considerations, or measures by neighbours and countries further afield that would go against their perceived interests. Yet until at least some of these changes happen, it is difficult to see Afghanistan finding its way to an upward path of real sustained growth.

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Design and layout by Žolt Kovač

Cover:
A tailor sews pakol hats at his shop in Khost.
Photo: Wakil Kohsar/AFP, 23 April 2024